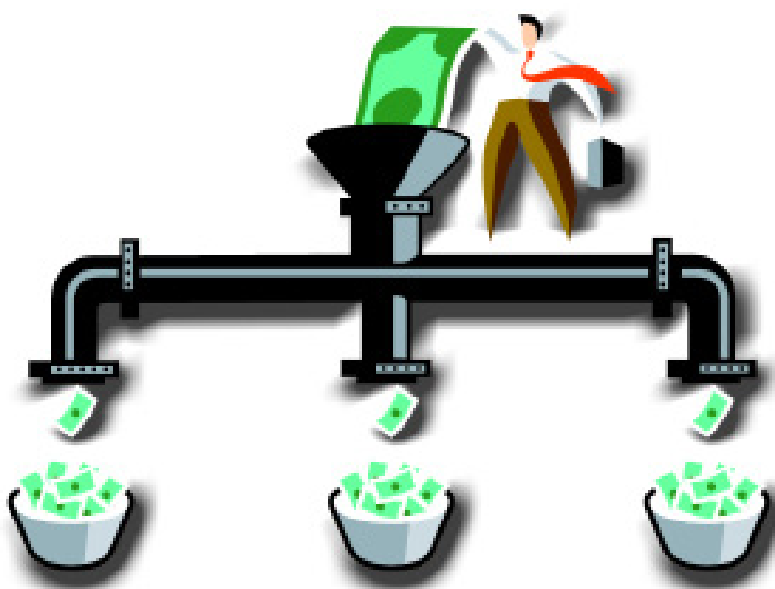


Thin Capitalization as a Tax Evasion Practice and its Control by the Tax Administrations

Marlon Vicente Manya Orellana



SUMMARY

Thin capitalization as a tax avoidance practice counteracts the transparency of the information that a tax administration pursues, and constitutes a latent problem that directly affects the erosion of the income tax taxable base. This article presents theoretical and legal aspects on this topic, and a benchmark related to the tax control applied by the OECD Ecuador, Argentina, Spain and Dominican Republic to address this problem.

***The Author:** Economist, Escuela Superior Politécnica del Litoral ESPOL. Master in International Applied Economic Relations, Universidad Internacional de Andalucía. Seville, Spain. Master in Treasury and Financial Administration, Universidad Nacional de Educación a Distancia, in agreement with the Fiscal Studies Institute and the Tax Administration Spanish Agency. Former Advisor to the Board of the Central Bank of Ecuador. Former Director of the Office of Economic Investigations of the Central Bank of Ecuador. Member of the Economic Research and Education Group of GRIDE. Tax Expert, Internal Revenue Service of Ecuador.*

INTRODUCTION

Contents:

Introduction.

1. Meaning of thin capitalization.
2. The dilemma: outside resources or the company's own resources.
3. Thin capitalization methods according to the OECD.
4. Thin capitalization control in the OECD.
5. Thin capitalization control in Ecuador.
6. Thin capitalization control in Argentina.
7. Thin capitalization control in Spain.
8. Thin capitalization control in Dominican Republic.
9. Conclusions.
10. Bibliography.

Thin capitalization involves the analysis of the forms of financing used by companies belonging to the same economic group that are linked and under common control. It is defined as any evident disproportion between the magnitude of the liability capital, established legally or statutorily, and the level of risk of the company that in each case is scheduled to implement the social purpose.

Speaking of capital, we have subscribed capital, i.e. the paid-up capital and the pending of disbursement capital, likewise, it is regarded as capital contributions from partners not formalized as equity premiums issues and contributions to compensate for losses, otherwise consider capital are positive results accumulated reserves.

The actual contribution of capital is overshadowed by the figure of the interest, which causes a change in the structure of the equity, indicating a minimum and at the same time attractive business risk for future partners, those who gain profit-earnings if the company presents positive results. These loans should have rates that are not higher than the rate authorized by the Central Bank, so they are appealing, and do not generate greater expenses to the related company acting as borrower and do not result being three times its equity.

On the other hand, it could happen that the group, in order to obtain this profit uses the legal location of the company generating the loan in a "tax haven" and this situation logically causes the increase in its profits. Conversely, if what is placed in the company is a contribution to the quality of the loan, it will charge yields regardless of the result of the company. Thin capitalization basically allow the relationships to take place between subsidiaries and the group they form part of, to act as a mask to conceal capital contributions, acquiring a tax advantage arising out of fiction financing with outside resources.

1. MEANING OF THIN CAPITALIZATION

Thin capitalization is the financing between undertakings of the same group which are located in different jurisdictions, to cover up funding with its resources with outside resources, where one of the parties is usually located in a tax haven or lower taxation country to minimize the taxable income of the company located in the country where more tax is paid. In other words, thin capitalization shows a company that is apparently funded through the access to credit, but is actually funded of share capital, in order to reduce the payment of the tax income through interest.

There are other definitions:

- **González Poveda**¹, “Thin capitalization is known as the elusive maneuver used by corporations, for tax reasons, to reduce or minimize the tax burden of the group, they turn to outside funding to conceal a genuine contribution of capital”
- **Silvia Catinot y Norberto Campagnale**², also commonly referred to as “little capitalization” (or “covert capitalization”), since it implies that a proportion of the corporate equity is financed through debt which is abnormally high in relation to the share financed with equity capital.
- **Lete**, defines thin capitalization as “the financial situation of a resident company in which the volume of the resources outside vis-à-vis its own resources exceeds the proportion which can be considered normal regarding operations carried out in free competition, seeking such situation through loans with non-resident related entities with the purpose of reducing for tax purposes of the taxable profits of the first company”.
- From the perspective of the **Spanish Mercantile Law**, “thin capitalization refers to social responsibility and the responsibility of the partners for corporate debts.” In that regard, this is the case of circumstances in which the partners or shareholders do not provide the resources necessary for the operation of the company, which results in a situation of insufficient capital.
- “In a broad sense, an entity is undercapitalized or in a situation of undercapitalization when its financial structure reveals a disproportion between the amount resulting from computing its own resources and the amount resulting from the various items comprising the outside resources.”³
- **García – Herrera Blanco**, “Thin capitalization consists of an elusive maneuver carried out by corporation for tax reasons, to reduce or minimize the tax burden of the group, turning to funding outside to conceal a genuine contribution of capital.

¹ *Non-resident taxation 1st and 2nd Edition, Spain 1989.*

² *Limitation to the deduction of interest, Silvia Catinot and Norberto Campagnale.*

³ *Undercapitalization doctrine: Conceptual approach to the undercapitalization of corporations.*

2. THE DILEMMA: OUTSIDE RESOURCES OR THE COMPANY'S OWN RESOURCES

Companies have different ways to obtain funding, either by provision of equity or debt. From the tax point of view any form of financing affects differently the tax burden, both for who receives this contribution and for who provides it. Outside funding is made by way of loans which are paid through the payment of interest, said funds come primarily from capital contributions made by members of the corporation; in the case of funds they are repaid through the payment of dividends.

The financed corporation considers the decision to use its own resources or outside resources and its decision directly impacts its tax base. Interests for the use of foreign capital are considered fiscally deductible expenses that reduce the taxable profit, on the other hand, the part of the benefit that the corporation distributes as a dividend to its partners part is not considered as a fiscally deductible expense, and therefore, comprises its tax base.

With regard to the taxation of each contribution generated by each class of funding, it can

be considered that the interests are taxed exclusively where they were made, because they are deductible in the taxable amount the payer, therefore there is no double taxation. Dividends instead support a less favorable regime, since double taxation agreements authorize higher charges compared to the interests of the source country, since States rarely unilaterally waive tax for a dividends obligation, hence, double international taxation normally occurs.

Because interest and dividends receive different tax treatment, the deductibility of the interest acts as primary element when deciding which financing is the right, therefore it is more attractive at the time of choosing financing between related corporations, because the loan it is a measure to reduce the tax burden through the increase in liabilities and therefore increase expenses and much lower earnings before taxes, seeming more reasonable to think that on many occasions financing through loans would be preferable.

3. THIN CAPITALIZATION METHODS ACCORDING TO THE OECD

The report of the OECD distinguishes two methods, **the subjective and objective**. The method that best fits the independence principle formulated by article 9 of the OECD model is **the subjective method**, which consists of verifying if resources obtained by the related lender have also been obtained from a third party. It maintains as the primary objective to determine if the corporation has or not the possibility of accessing credit from a stand-alone where the

tax administration is responsible for performing this test. This report states that in order to analyze this situation the following data must be compared:

- a) debt ratio / capital before the operation
- b) if the loan is intended to cover losses
- c) its possible convertibility into shares
- d) the linking of interests to the corporate profits
- e) subordination to other creditors.

With these criteria what they find is a possible involvement of the risks of the company by the lender, if this happens, it would not find to a loan in the free market, therefore, interests would be close to be considered dividends. Similarly, when you attempt to set a normal price to competition in related party transactions, it is complicated and difficult and the field test on thin capitalization is also complex to verify.

The target method is based on different parameters, the same that is used by a large number of countries. This means that the corporation may not exceed its indebtedness three times more than its share capital. If this limit is exceeded, it is undercapitalized. The legal consequences of the tax standard shall apply on the excess. Due to the rigidity of this method of the OECD report sets certain precautions, which mentions that if a corporation exceeds the debt ratio, this is only compatible with the principle of full jurisdiction (Article 9), if it proves that the indebtedness conforms to the principle of independence (e.g., demonstrating that it corresponds to routine indebtedness in companies in the same branch of activity in

the country) and avoid the consequences of the thin capitalization standard.

Then, the test is to verify that resources obtained as a loan by a related company would have also been obtained by an independent. Then means its indebtedness with related companies is only circumstantial, since the company's credit capacity would have equally allowed it to obtain outside resources from third parties. The test is similar to the subjective method. The taxpayer must prove that its indebtedness with related subjects, while exceeding the legal limit, is in accordance with the principle of independence. Which indicates its credit capacity is not yet exhausted. It also clarifies that the existence of a single debt ratio for all kinds of corporations is not the most optimal situation, since each economic sector operates with different levels of indebtedness, therefore, a single coefficient may be detrimental to taxpayers. Considering this, the recommendation is to establish different rates depending on the sector where each corporation acts. Otherwise, you would force taxpayers to report when from the economic point of view, the tax debt ratio is lower than the economic sector where it operates.

4. THIN CAPITALIZATION CONTROL IN THE OECD

The following are the OECD's thin capitalization standards:

- a) **Australia.** There is specific legislation on thin capitalization which takes into account the type of interest rate, the amount of the loan and equity ratio which is 3: 1.
- b) **Belgium.** Loans between related companies are subject to a restrictive rule only when they are done by shareholders who are in turn company managers.
- c) **Canada.** Loans concluded by a Canadian entity to its foreign subsidiary consider their yield as a dividend if its duration is over one year since the end of the year of its establishment. Interest rates are determined in a pre-established manner.
- d) **France.** The equity ratio is 1.5 to 1 when funds are provided by a controlling non-French shareholder company.
- e) **Germany.** In most cases the equity ratio is 3 to 1, 0.5 to 1 applies when the return of capital varies with the earning and is finally 9 to 1 for holding companies. Applies both to residents and nonresidents.
- f) **Italy.** Does not have specific standards.

- g) Japan. The equity ratio is 3 to 1. Now, this rule is not applied if there are higher ratios in comparable independent companies.
- h) **The Netherlands.** It has no specific standard. Tax authorities analyze the interests depending on the obligations contracted by the loan.
- i) **Spain.** The ratio is 3:1. As from 2004 its application is excluded to entities residing in countries of the European Union
- j) **Sweden.** It has no specific standard, but the inspection may prove in the courts that there is thin capitalization.
- k) United Kingdom. English statutes treat interests such as benefit-sharing unless the terms of the double taxation treaty proves that they are interests. In this case the equity ratio is 1:1.
- l) **United States.** There are different levels of interest for different loans. The equity ratio is 3:1. There are introduced in the calculation of the loan equity ratio which is guaranteed by a related entity.

Where there is are thin capitalization clauses, the tax authorities adjusted interest rates when the loan amount is high, but they can also adjust this amount. The equity ratio exists under provisions of the limitation of interest payments.

5. THIN CAPITALIZATION CONTROL IN ECUADOR

Article 10 of the Organic Internal Tax Law⁴, states in paragraph 2, the need to establish an optimum level of indebtedness: “to make deductible the interests paid by external credits granted directly or indirectly by related parties, the total amount of these may not be greater than 300% with respect to the equity, in the case of corporations. In the case of individuals, the total amount of external credits shall not be greater than 60% with respect to its total assets. The interest paid in excess of the relationships indicated, will not be deductible.”

Accordingly, article 30 of the regulations for the implementation of the Organic Internal Tax Law in item II, states that interests generated by offshore credits will be deductible, when acquired for the course of business, until the rate authorized by the Central Bank of Ecuador, these interests and their payments are registered with the Central Bank of Ecuador; and they meet the following conditions:

- For corporations, interests generated by external credits will be deductible provided that the relationship between the total external indebtedness and the paid social capital does not exceed 300 per cent.
- For individuals with bookkeeping requirements, interest generated by external credits shall be deductible provided that the relationship between the total external debt and total assets does not exceed 60%.
- For foreign branches interest generated by foreign loans will be deductible provided that the relationship between total external indebtedness and allocated capital does not exceed 300%. External credits received from their headquarters shall not be considered.
- For oil company consortiums without legal capacity, interest generated by foreign loans shall be deductible provided that the relationship between total external indebtedness and the net difference between its total assets and liabilities does

⁴ *The Amended Organic and Interpretation Law to the Organic Internal Tax Law, to the Tax Equality Law of Ecuador and the Electric Power Section Regime Law, Official Registry. 392-2S, 30-VII-2008*

not exceed 300%. For this purpose, those amounts which are the result of accounting adjustments shall not be considered. External credits received by the members of the Consortium, their headquarters shall not be considered.

- De facto companies and other companies without legal capacity, interest generated by foreign loans shall be deductible provided that the relationship between total external indebtedness and the net difference between its assets and liabilities does not exceed 300%. For this purpose, those amounts which are the result of accounting adjustments shall not be considered.
- In the case of commercial trusts interest generated by credits from abroad will be deductible, provided that the relationship between the total external indebtedness and the summation of the contributions made by the constituents and adherents does not exceed 300%.

Where debt ratios mentioned above, exceed the limit set at the time of accruing the expense by concept of interest, the expense portion generated on the excess of the corresponding relationship, without detriment to the withholding at source of the income tax over the total interest will not be deductible. Taxpayers shall proceed with the corresponding reassessment of the tax, without detriment to the assessment capacity of the Tax Administration when the debt ratio is modified. External debt shall be understood as the total debt contracted with individuals and bodies corporate abroad. For the purposes of the implementation of the Internal Tax Law, the rate authorized by the Central Bank of the Ecuador to be applied to external credits will be that existing at the date of the registration of credit in the Central Ecuador Bank in accordance with the Law. If the external credit rate exceeds the rate authorized by the Central

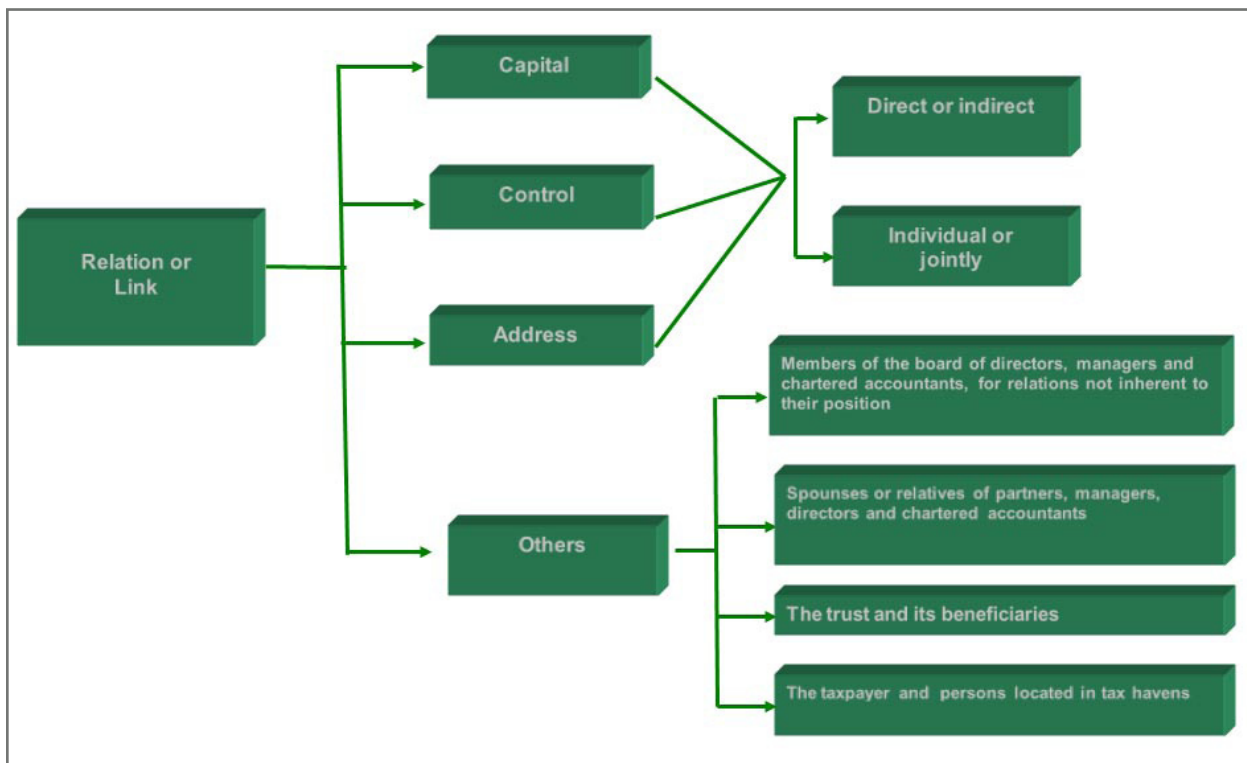
Bank of the Ecuador for credits from abroad, interest in the surplus portion of the authorized rates shall not be deductible.

The problem lies in the control of thin capitalization, as there are companies that opt to borrow capital from its partners, or with related companies belonging to the same. The amount of funding usually exceeds the possible amount that might be obtained in the financial markets from third parties. This leads to the existence of links between Contracting Parties. Regardless of this premise, and considering that each operator is aware of what is optimal for itself, the ideal tax policy to correct distortions in the ratio (debt/assets) generated by the real existing tax benefits via debt interest deductions, would be in creating and improving a equivalent stimulus on the side of the equity, in particular through the reinvestment of profits and regulating internal or external linked credits through the regulation of transfer pricing; so the tax rate savings per dollar of debt is equal to this same rate per dollar of equity.

That is, decisions to allocate money to debt and equity must be viewed as if they were two perfectly substitutable goods between themselves, showing at the end, the real debt-equity ratio that should exist for each firm.

With the Tax Equality Amendment Law⁵, the concept of related parties is incorporated into the Organic Internal Tax Law, in its article 4: "For tax purposes related parties shall be deemed to be individuals or companies, domiciled or not the Ecuador, where one of them is directly or indirectly involved in the direction, management, control or capital of the other; or where a third party, whether an individual or a company, domiciled or not in the Ecuador participates directly or indirectly, in the direction, management, control or capital of these".

⁵ Published in the third Supplement of Official Registry No. 242, 29 December 2007

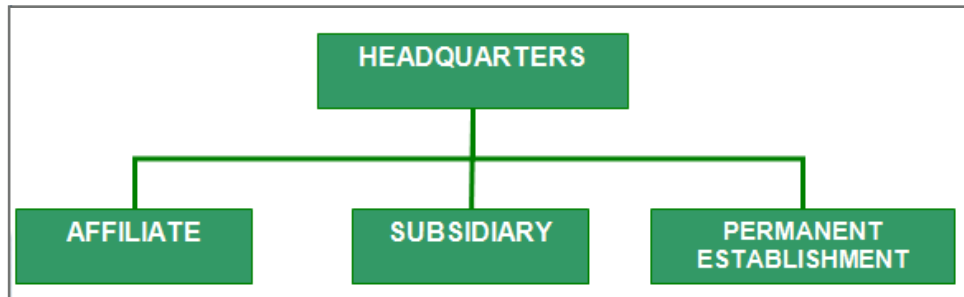


Official Registry No. 337, 15 May 2008, published the Regulations for the implementation of the Organic Internal Tax Law, indicating in its articles relating to transfer pricing the following: in Article 4 thereof, in order to establish related parties, in addition to those mentioned in the Law, the Tax Administration in order to establish some kind of link for percent of capital or transaction share, it shall take into account, inter alia, the following cases:

1. When a natural person or company is the holder directly or indirectly of 25% or more of the share capital or equity in another company;
2. Corporations in which the same partners, shareholders or their spouses or relatives to the fourth degree of consanguinity or second of affinity, participate directly or indirectly in at least 25% of the share capital or equity;
3. Where an individual or company is holding directly or indirectly 25% or more of the share capital or equity in two or more companies;
4. When an individual or company, domiciled or not in the Ecuador does 50% or more of its sales or purchases of goods, services or other operations, with an individual or company, domiciled or not in the country;

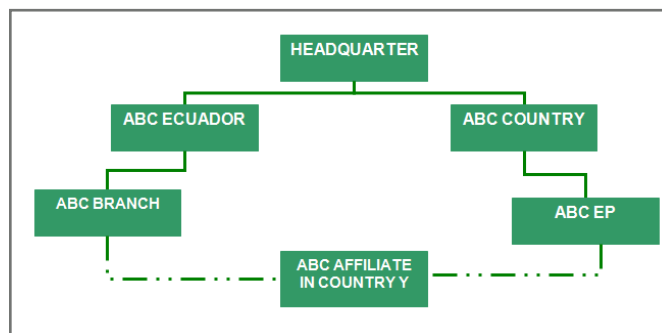
Graphically related parties are displayed as follows:

1. Affiliates, subsidiaries or permanent establishments with each other.



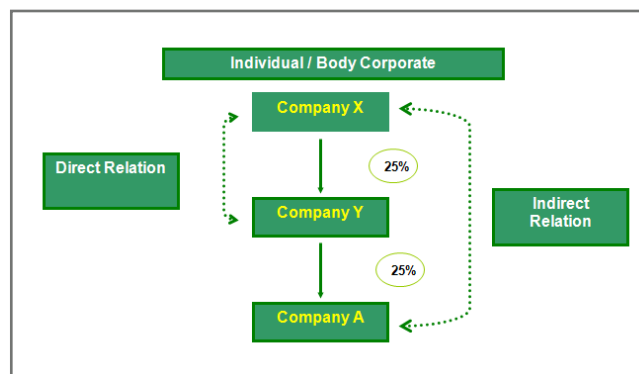
By the headquarters having a direct relation with its affiliate, subsidiary or permanent establishment, they are considered related.

2. Affiliates, subsidiaries or permanent establishments with each other.



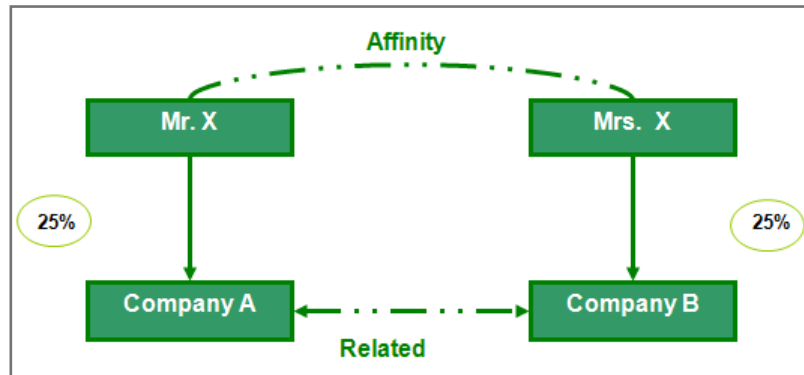
A percentage does not have to be established to determine relationship because headquarters directly exercises control and management.

3. When the individual or the body corporate owns directly or indirectly 25% or more of the capital stock or equity in another company, these will be related with each other.

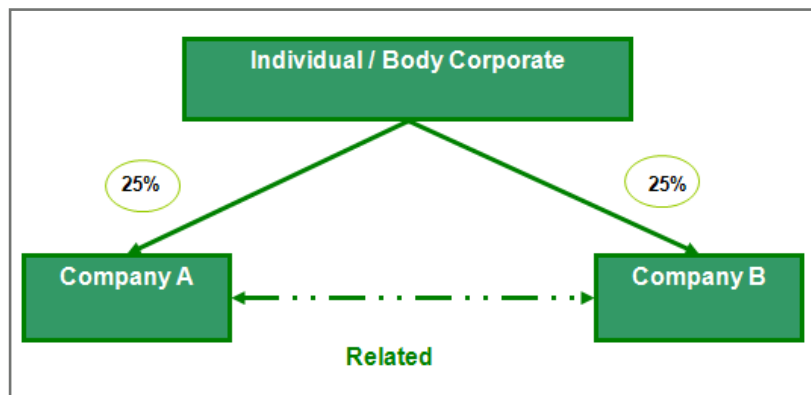


For owning 25% or more of the capital stock or equity, they are considered related

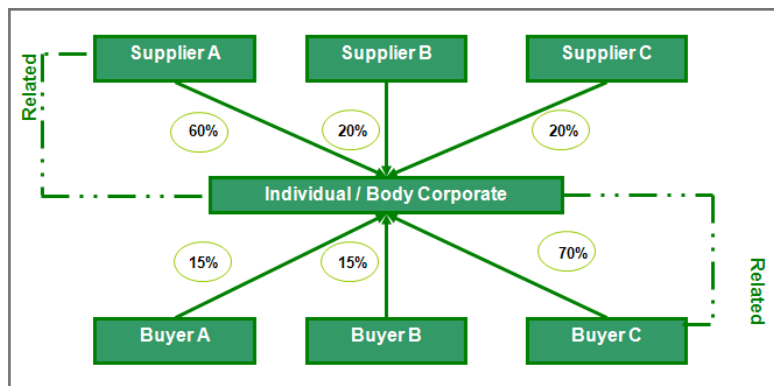
- Two companies where the partners, shareholders or spouses or their relatives up to the fourth degree of consanguinity or second of affinity, participate directly or indirectly in at least 25% capital stock or equity.



- When the individual or the body corporate owns directly or indirectly 25% or more of the capital stock or equity in two or more companies, these will be related with each other.



- When the individual or the body corporate, with domicile or not Ecuador, performs over 50% or more of its sales or purchases of goods, services or another type of operations, with an individual or corporation domiciled or not in the country.



Suppliers or clients, which transactions exceed 50% or more in their purchases or sales, the link are established.

Furthermore, the following aspects were included:

- “Taxpayers are considered related parties when they perform transactions with corporations domiciled, incorporated or

located in a low taxation jurisdiction or in tax havens.⁶”

- “Similarly, the Tax Administration may establish related parties by presumption, when the transactions that are done do not adjust to the arm’s length principle.”

6. THIN CAPITALIZATION CONTROL IN ARGENTINA

The reform was established by Law No. 25,063, it shows changes in the Profits Tax, the Value Added Tax and created a new tax on interest paid and the financial cost of the business indebtedness to regulate the problem of thin capitalization. These variations with their restrictions were made to obtain, maintain, and preserve encumbered and not encumbered profits generated by different production sources, stating also that the deduction will be of the gross earnings that each of them produces respectively, including results exempted from the encumbrance, i.e. that the subject company shall deduct interests in function of the proportion represented by the taxed earnings in regards to the total earnings (taxed, exempt and non-taxable). Law 25,063, adds a third paragraph to paragraph a) of Article 81 of the law establishing another constraint to the deduction of interest from debts by certain subjects, in the proportion corresponding to the largest surpluses arising from the limitations and provided that the same disburse jointly.

Regarding the payment of interests, the subject receiving the loan must pay 35% of the total interest expense with the purpose that the beneficiary of the interests does not pay said tax. Hereinafter, are details of Reform 25,063: “In the case of subjects under Article

49, excluding the entities ruled by Law 21,526, debt interests with the exception of those corresponding to loans granted by individuals or domiciled undivided interests or, as the case may be, domiciled in the country, including those in item 2 letter paragraph c) of Article 93 and forty percent (40%) of the remaining, of the corresponding taxable balance shall not be deducted, in the proportion corresponding to the greatest surplus resulting from the following limitations and provided that these take place jointly:

1. The total amount of liabilities that generate interests with the exception of amounts corresponding to the loans granted by individuals or undivided inheritance and foreign beneficiaries excluded from the limitation at the closing of the year, should not be greater than two and a half (2.5) to the amount of equity on the same date;
2. “The total amount of interests with the exception of the corresponding loans by individuals or undivided inheritance and offshore beneficiaries, excluded from the limitation must not exceed fifty percent (50%) of net income subject to tax for the period, determined prior to the refund thereof.”

⁶ Resolution NAC-DGER2008-0182. Published in Supplement two of Official Registry No. 285, 29 February 2008

Interests shall be deducted in the taxable balance, provided that the loans are granted:

- a) By domiciled individuals or independent bodies corporate or as the case may be, domiciled in the country
- b) May fully deduct interest on debt in tax income, but must pay 35% on said interests as tax on interest paid and the financial cost of borrowing entrepreneur, excluding banking and financial entities.
- c) By subjects from abroad (individuals, companies, banking or financial institutions) that are not a bank or financial institution established in countries in where their central banks have adopted international banking supervision standards established by the Basel Banking Committee. Excluding financial institutions, may fully deduct debt interests from the Profits Tax, but foreign beneficiaries receiving these incomes will suffer a withholding as a unique and definitive payment in respect of the 35% Profits Tax.

3. For the remaining subjects that are not covered in items 1) and 2) above (companies that are related). In these cases with the exception of banking, and financial entities they may only deduct 40 percent of debt interests, the remaining 60% will not be deductible.

When the restriction of the above analyzed interest deduction takes place, the surplus of non-deducted interest may be charged to the following fiscal years, 5 years since the origin thereof, taking into account for each, the limits mentioned above. Changes made to thin capitalization regulations prevent tax avoidance through the use of interest as a way of paying dividends. The previous standard establishes restrictions to resident companies, with this the transfer of the taxable matter to other States is encouraged, since interests remained in the country and the same beneficiary paid the tax. On the other hand, the fact of considering the interests in the liabilities that twice exceeds the net capital and that they are treated as dividends is one more point incorporated into this legislation.

7. THIN CAPITALIZATION CONTROL IN SPAIN

Article 20 of the current Consolidated Text of the Corporate Income Tax Law (TRLIS) rules thin capitalization in Spain. This norm has as a purpose to prevent the deduction of interests earned from a loan considered by the legislator as excessive, caused them to be considered dividends.

1. If net debt paid, directly or indirectly, of a corporation with another or other related companies, excluding financial institutions,

exceeds three times the fiscal capital, accrued interest corresponding to the excess will be treated as dividend.

2. For the purposes set forth in the preceding paragraph, both paid net debt and fiscal capital will be reduced to their half status throughout the tax period.
3. Tax capital shall be understood as the amount of the entities equity, not including the result of the fiscal year.

7 Edgar Morales Perez: "The Problem of Thin Capitalization and the Measures to Counteract the same in the Dominican Republic."

4. According to article 16.7 of the Corporation Tax Law, the taxpayer may refer to the tax administration a proposal for the implementation of a coefficient other than that provided for in paragraph 1, the same is based on the fact that entity would have been able to obtain the loan in normal market conditions by a non-related corporation.
5. Is not applicable if the loan is made to resident individuals or entities in countries considered tax havens.

In the case that the taxpayer submits a proposal to the tax administration to apply another coefficient different from the one established law, this only possible for entities residing in territory of the European Union, with the exception of those which are tax havens. In this regard, excessive indebtedness is any loan exceeding this amount, determining that any excess must be taxed as a dividend. Furthermore, resident corporation can argue with the legislator a proposal for the implementation of a different coefficient ratio, which exceeds the one established by law. This proposal is consistent with transfer pricing standards mentioned in article 16.6 TRLIS, it must be based on the debt that the subject would have been able to obtain with unrelated third parties.

Another assumption is that thin capitalization is where the creditor resides in a country or territory considered as tax haven, whereas the resident company may not request any proposal to modify the ratio according to the anti-haven standard in Article 14(1) letter g of the TRLIS, except in the case that the related entity is a

resident of a member state of the European Union, unless this State is designated as a tax haven. This rule is characterized by the following:

1. Net borrowing: If there are active and liability balances with the same related entity, the net balance of these items will be addressed.
2. Is not considered indebtedness with financial institutions, when these are considered as typical business thereof.
3. It talks about accrued interests, i.e. do not have to be actually paid.
4. To determine net debt and the tax capital figure, the mean balance of the taxable period will be addressed.
5. Tax capital shall be understood as the amount of equity of the entity, without including the results of the fiscal year.

Pursuant to the terms of articles 16 to 28 of the TRLIS taxpayers are expected to make proposals on a coefficient other than that provided for in Article 20.1 although this shall not apply to transactions carried out with or by persons or entities resident in tax havens. In the case of companies that pay taxes through a consolidated Group at the time of assessing the capital tax each individual company shall be addressed and there will be no possibility of accumulating all members of the group.

8. THIN CAPITALIZATION CONTROL IN DOMINICAN REPUBLIC

This country does not have provisions created specifically to counter the thin capitalization, however, the tax code collects a set of measures that help prevent Thin capitalization:

- Does not admit the deduction of the payment of interests, royalties, or technical assistance incurred by subsidiaries established in the country to its headquarters abroad if the 25% withholding have not been paid.
- When a company domiciled in the country pays interest on loans contracted with foreign credit institutions must retain 10% of those interests as tax payment. If the payment is not a credit institution it must retain 25% of the payment made.
- When the headquarters distributes corporate costs to the branch or establishment in the country, and the same do not correspond to the value of these costs for similar services charged between independent undertakings, the tax administration can challenge them.
- When the amounts paid or payable as interest, commissions, or any other payment, coming from credit or financial transactions between the headquarters and its subsidiary are considered excessive, the Tax Administration can challenge said excess as a non-necessary expense. That is, the assess expense shall not be deductible when assessing the taxable income.⁷

9. CONCLUSIONS

- The change of economic model derived from globalization, resulted in this case presented by the increase in flows of capital, has meant a change in the nature and the foundations of the economic relations between countries. Taxation is still inadequate to solve the specific problems posed in this new open economy model.
- Thin capitalization as a tax avoidance practice is one of the techniques most widely used, and consists in the funding between undertakings of the same group which are located in different jurisdictions, with the purpose of covering up funding with its own resources by outside resources, where one of the parties usually is located in a tax haven or lower taxation country to minimize the taxable profit of the company located in the country where higher taxes are paid.
- There are different methodologies to mitigate their impact, being the most used the ratio between the mean indebtedness and the equity or the company's net equity.
- The problem is in the control of the thin capitalization, as there are companies that opt to borrow capital from their partners, or the related companies belonging to the same. The amount of funding usually exceeds the possible amount that might be obtained in the financial markets with third parties. This leads to the existence of links between Contracting Parties

- Regardless of this premise, and considering that each operator is aware of what is optimal for itself, the ideal tax policy to correct distortions in the ratio (debt/assets) generated by the real existing tax benefits via debt interest deductions, would be in creating and improving a equivalent stimulus on the side of the equity, in particular through the reinvestment of profits and regulating internal or external linked credits through the regulation of transfer pricing; so the tax rate savings per dollar of debt is equal to this same rate per dollar of equity
- Accordingly, decisions to earmark the money to debt and equity must be viewed as if they were two perfectly substitutable goods among themselves, showing at the end, the real debt-equity ratio that should exist for each company

10. BIBLIOGRAPHY

BARBETTI Nilda Noemí “La subcapitalización” IEFPA, (Buenos Aires, 2001)

CAMPAGNALE, Norberto P. y CATINOT, Silvia G., “Limitación a la deducción de intereses. Análisis de la nueva reglamentación y de su compatibilidad con los convenios para evitar la doble imposición internacional suscriptos por la Argentina.” Revista Doctrina Tributaria.(Enero 2005)

CÓDIGO TRIBUTARIO de República Dominicana. Ley No. 11-92 (Abril 1992)

CORDÓN Ezquerro Teodoro, GUTIÉRREZ LOUSA Manuel “La subcapitalización: Tratamiento jurídico- tributario y su compatibilidad con el principio de no discriminación” p. 299-331. (2001)

COSÍN Ochaita Rafael “Fiscalidad de los precios de transferencia” (Enero 2007)

CHEVARRÍA Zully “La naturaleza de la subcapitalización y su aplicación práctica como norma doméstica antielusión en España” Pontificia Universidad Católica del Perú. Departamento Académico de Ciencias Administrativas. (Julio 2008)

DELGADO Abelardo, Garrigues & Andersen “Algunas cuestiones dudosas en torno a la subcapitalización” (Julio 2001)

GONZÁLEZ Poveda, “Tributación de no residentes, Fiscalidad Internacional Española, Impuestos sobre Sociedades y sobre la Renta de Personas Físicas” 1ª y 2ª edición. (1989).

GUASCH Martorell Rafael, Revista de Derecho Mercantil de España: “La Doctrina de la infracapitalización: Aproximación conceptual a la infracapitalización de sociedades”. ISSN 0210-0797, N° 234, pags. 1489-1514, (1999)

INSTITUTO DE ESTUDIOS FISCALES (IEF), Escuela de Hacienda Pública “Manual de Fiscalidad Internacional “Segunda Edición. I.S.B.N.: 84-8008-165-1 (Septiembre 2004)

MORALES Pérez Edgar: “El Problema de la Subcapitalización y las Medidas para Contrarrestarla en la República Dominicana” Secretaria de Estado de Hacienda. Departamento de Estudios Económicos, Texto Informativo No. 4 (Agosto 2007)

ORGANIZACIÓN PARA LA COOPERACIÓN Y EL DESARROLLO ECONÓMICOS (OCDE) “Directrices aplicables en materia de precios de transferencia a empresas multinacionales y Administraciones Tributarias” Secretaría de Hacienda y Crédito Público, Servicio de Administración Tributaria, para la edición en español. Traducido por el Instituto de Estudios Fiscales (IEF), Madrid, bajo convenio con la OCDE. (2002).

SERVICIO DE RENTAS INTERNAS DEL ECUADOR. Ley Orgánica Reformatoria e Interpretativa a la Ley Orgánica de Régimen Tributario Interno, a la Ley para la Equidad Tributaria del Ecuador y a la Ley de Régimen del Sector Eléctrico, Registro Oficial. 392-2S, 30 de Julio del 2008.

SERVICIO DE RENTAS INTERNAS DEL ECUADOR. Ley Reformatoria para la Equidad Tributaria, Tercer Suplemento del Registro Oficial No. 242 del 29 de Diciembre del 2007

SERVICIO DE RENTAS INTERNAS DEL ECUADOR. Resolución NAC-DGER2008-0182 del 21 de Febrero del 2008.

SERVICIO DE RENTAS INTERNAS DEL ECUADOR. Segundo Suplemento del Registro Oficial No. 285 de 29 de Febrero del 2008

SERVICIO DE RENTAS INTERNAS DEL ECUADOR. Reglamento para la aplicación de la Ley de Régimen Tributario Interno. Disposiciones reglamentarias sobre la forma de aplicación de la LRTI. Decreto No 374, Suplemento del Registro Oficial 209, del 8 de Junio del 2010.

VEGA Borrero, Félix Alberto. “La norma tributaria en materia de subcapitalización: incidencia de los convenios de doble imposición y del derecho comunitario”. Crónica Tributaria N° 104, pp.89-125. Universidad Autónoma de Madrid” (2002).